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INSPECTOR GENERAL

The Commonwealth of Massachusetts
Office of the Inspector General

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John Fletcher and Donna Goodell
Co-executive Directors
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Billerica, MA 01821

Dear Mr. Fletcher and Ms. Goodell:

The Office of the Inspector General (OIG) is currently reviewing matters regarding the Merrimack Special Education Collaborative (MSEC) and Merrimack Education Center, Inc. (MEC).

One focus of our review has been the set of agreements signed by MSEC and MEC in 2006, 2007 and 2009, setting the terms under which the two organizations do business with each other. These agreements have collectively transferred more than \$18 million from MSEC, a public entity established under M.G.L. c.40 §4E, to MEC, a private non-profit.

I am writing to notify you that the agreements violate M.G.L. c.30B, the Uniform Procurement Act, and are, therefore, invalid. The OIG recommends that MSEC immediately cease paying MEC for services and demand that MEC return a minimum of \$11.5 million to MSEC. MSEC should then in turn refund the school districts which, through tuitions paid to MSEC, were the original source of the money.

I am also forwarding this letter to the school committees of MSEC's member districts. As described below, the contracting process obligating MSEC to pay MEC more than \$3 million a year was also tainted by multiple conflicts of interest and manipulated to avoid scrutiny from objective parties.

In June 2006, the boards of MSEC and MEC ratified a pair of agreements. One document, called the Settlement Agreement, claimed that MSEC had underpaid MEC more than \$7.4 million for rent, building improvements and various administrative services over the prior six years. This agreement purported to settle that claim under the

following terms: MSEC would transfer \$4 million immediately to MEC and pay another \$1.5 million in annual \$250,000 installments over the next six years.

The second document, called the Administrative Services and License Agreement, establishes the contractual terms between the two organizations for the following 10 years. It sets the rental rates for the buildings MSEC leases from MEC as well as a formula under which MSEC pays MEC for a variety of services, including personnel, IT, legal, accounting and building maintenance services. Under this agreement, MEC is MSEC's exclusive provider of real estate and professional services, for which it is paid in excess of \$3 million per year.

M.G.L. c.30B applies to the acquisition of supplies and services, the disposition of supplies and the acquisition and disposition of interests in real property by a governmental body. A governmental body is defined as a city, town, district, regional school district, county, or agency, board, commission, authority, department or instrumentality of a city, town district, regional school district or county. Educational collaboratives are instrumentalities of their member school districts, and are therefore subject to M.G.L. c.30B. Member school districts can contract for services with an educational collaborative without a bid process via intergovernmental agreements. However, educational collaboratives must follow M.G.L. c.30B when they procure supplies and services or acquire or dispose of real property.

Although M.G.L. c.30B §1(b)(8) exempts "the provision of special education" from its competitive procurement rules, this exemption applies only to the direct services delivered to children with special needs, such as transportation, counseling and educational programming.

Under M.G.L. c.30B, the real property, personnel, IT, and building maintenance services that MSEC procured from MEC, should have been competitively bid. It is our understanding that MSEC never bid the services and/or real property that are the subject of the 2006 Administrative Services and License Agreement, which compels MSEC to obtain all real estate and services "from MEC alone" for 10 years. MEC and MSEC replaced the 2006 Administrative Services Agreement in October 2009 with a similar 10-year, no-bid contract.

While some of the services in both the 2006 and 2009 contracts may have been exempt from M.G.L. c.30B, such as the services of an attorney or a certified public accountant, when a contract comingles services subject to M.G.L. c.30B with services that are exempt, the entire contract is rendered subject to M.G.L. c.30B.

M.G.L. c.30B §17(b) clearly states "a contract made in violation of this chapter shall not be valid, and the governmental body shall make no payment under such contract." Therefore, the OIG recommends that MSEC immediately cease its payments to MEC.

In addition, the Settlement Agreement claims to address MSEC's underpayment for supplies, services and real estate provided by MEC between 2001 and 2006. We

believe the only prior written service agreement between MSEC and MEC was entered into in 1991 and extended indefinitely by addendum in 1992. The 1991 Agreement only addresses MSEC's purchase of fiscal services from MEC. It does not contemplate the real property leases, acquisition of supplies or renovation costs that make up the bulk of the Settlement Agreement's \$7.4 million claim.

Pursuant to M.G.L. c.30B, §17(a), a governmental body may not pay for supplies or services rendered prior to the execution of a written agreement. The failure to competitively procure the supplies, services and real property in question in accordance with M.G.L. c.30B, makes the Settlement Agreement invalid. Therefore, the OIG recommends that MSEC immediately cease all payments under the Settlement Agreement.

Furthermore, while the two agreements are purportedly between two "independent contractors," these documents were in no sense arm's length agreements and are tainted by conflicts of interest.

First of all, the two organizations have operated as a single entity for virtually their entire history, with overlapping boards and intertwined payrolls. Tax filings, board minutes, audits and operational practices over two decades clearly establish that MEC's board and employees exercised control over MSEC until about two years ago when the organizations came under outside scrutiny. Throughout their joint history, the governmental body has been identified and operated as a captive subsidiary of the non-profit organization. While the agreements superficially appear to be between two independent parties, the reality is that MSEC was a subordinate arm of MEC.

Multiple conflicts of interest cloud these agreements. The agreements were signed by John B. Barranco, as executive director of MEC, and Mary Clisbee, as executive director of MSEC. These two individuals were in the eighth year of a personal relationship and had shared the same residence in Groveland for several years at the time the contracts were signed; according to a sworn affidavit Ms. Clisbee filed in Essex Superior Court in June 2007. Also, Ms. Clisbee received annual bonus payments from MEC in amounts subject to the discretion of Mr. Barranco. In October 2006, she received a bonus of nearly \$140,000.

As I indicated earlier, the boards of MSEC and MEC had overlapping memberships. On June 5, 2006 in order to ratify the two agreements, Ms. Clisbee convened a special meeting of the MSEC board "to discuss matters of business that cannot wait until our next regularly scheduled meeting" in November.

Of the nine superintendents who routinely attended MSEC board meetings, five superintendents showed up for the special session. All five in attendance were simultaneously members of the MEC board, but acted as the MSEC board to transfer \$5.5 million to MEC. Two of the five superintendents, longtime allies of Mr. Barranco, were due to retire at the end of month and would be replaced on the MSEC board. Just weeks after the vote, these two people were hired to high-paying jobs at MEC. A third

superintendent who voted to transfer the \$5.5 million retired from his school district post in 2008 and was hired at MEC.

In addition to the multiple conflicts of interest, there was no legal quorum at MSEC's special meeting.

At the time of the June 2006 vote, MSEC was comprised of only seven member school districts: Billerica, Chelmsford, Dracut, Groton-Dunstable, Tewksbury, Tyngsboro and Westford. However, the superintendents from Stoneham and the North Middlesex Regional School District routinely attended MSEC board meetings and, despite the fact that they were not legally members of the MSEC board, they routinely voted as if they were.

According to MSEC's Articles of Agreement, "At least four voting members of the M.S.E.C. Board must be present to constitute a quorum." Of the five superintendents who attended the June 5, 2006 special meeting, only three were voting members of MSEC. Two were not.

In other words, these two crucial documents were approved without a quorum present to take official action.

The effects of these agreements on the finances of the two organizations have been profound. In June 2006 prior to MSEC and MEC's ratification of the agreements, MSEC had a \$4.6 million surplus on its books, while MEC's surplus was under \$2 million. As of June 30, 2010 MEC had a \$20.9 million surplus. MSEC owed MEC more than \$2.75 million and had an operating deficit of \$50,000.

Through fiscal 2009, MEC's tax returns consistently identified MSEC as a "related organization." In their audited financial statements, both MEC and MSEC refer to their agreements as "related party" transactions. In 2010, MEC's tax returns and audited financial statements recast its relationship with MSEC. Although their agreements are still described as "related party" transaction, MEC no longer claimed MSEC as a "related organization." Instead, it expanded its description of its charitable purpose to include providing "administrative and consulting services" to local school districts.

Given the multiple conflicts of interest described above, the lack of a competitive process to establish the value of the services MEC sells to MSEC and MEC's claim that providing such services are part of its charitable mission, the OIG used MEC's underlying costs to estimate the value of its services.

My staff has analyzed hundreds of pages of invoices, payment records, and other business documents reflecting transactions between the two related organizations. Overall, the financial arrangements between the two are lopsided heavily in MEC's favor, allowing it to charge to MSEC amounts far in excess of its own costs. These excessive costs in turn get passed along to school districts in the form of higher tuition

rates. This is contrary to the intent of the Legislature in establishing educational collaboratives.

For example, between Fiscal Year 2001 and Fiscal Year 2005, MEC leased space in four buildings to MSEC. During that same time period, MEC's mortgage cost for those buildings was \$992,880, according to the financial statements MEC files with the Massachusetts Attorney General's Non-Profit Organizations and Public Charities Division and mortgage documents filed with the Middlesex County Registry of Deeds. These mortgage obligations include money MEC borrowed to finance renovation of the buildings.

Documents provided to the OIG to justify the 2006 Settlement Agreement show that during these years, MEC charged MSEC \$1.3 million in rent for this space, 35 percent higher than its costs. In these documents, MEC describes the \$1.3 million as an underpayment.

The 2006 Settlement Agreement has an attached spreadsheet labeled "Schedule 1.01" that effectively doubled MSEC's rent from fiscal 2001 to 2005 to \$2.6 million, more than double MEC's actual mortgage costs. The 2006 Settlement Agreement charged MSEC another \$1.4 million for building improvements.

MEC officials used these charges in excess of its costs to help create a pretext for the Settlement Agreement, under which MSEC paid \$4 million in June 2006 and four subsequent payments of \$250,000 each year since that date.

In Fiscal Year 2007, the Administrative Services and License Agreement set the rent at \$16 per square foot per year, amounting to \$1.6 million a year. In fiscal 2007, MEC's mortgage costs for all its buildings – including buildings used exclusively by MEC – was \$503,088.

In October 2009, MEC and MSEC signed a new Administrative Services and License Agreement, committing MSEC to purchasing administrative services exclusively from MEC for the next 10 years and renting MEC's buildings at a minimum of \$23 per square foot per year. This rental rate is significantly higher than advertised market rates in the Chelmsford and Billerica markets. Under these terms, MSEC is paying MEC about four times MEC's mortgage costs. Neither MEC nor any MSEC officials have provided any evidence that the rents charged to MSEC corresponded to either fair market value or MEC's own costs of ownership. Cumulatively, between Fiscal Year 2007 and Fiscal Year 2010, MEC has charged MSEC at least \$6.5 million in excess of its own real estate-related costs.

Given that MEC is a tax-exempt organization established to support local school districts, it should not be reaping a windfall from its real estate holdings.

The 2006 Administrative Services and License Agreement and its 2009 successor also set terms under which MSEC pays MEC for payroll, technology, human resources,

insurance and administrative services. Between Fiscal Year 2007 and Fiscal Year 2010, MSEC has charged MEC more than \$3.2 million for these services. MEC also charges MSEC for providing transportation services for students. In Fiscal Year 2010, the charges for transportation services amounted to about \$560,000. I believe these charges deserve scrutiny to determine whether MEC overcharged MSEC.

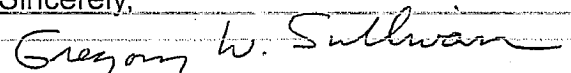
The 2009 Agreement also created a line of credit to allow MSEC to borrow up to \$1.25 million from MEC. By June 30, 2010 MSEC had tapped out its line of credit, having borrowed \$1.25 million from MEC. MSEC also owed MEC more than \$1 million for Administrative Services and License Agreement fees MSEC was unable to pay on time.

There is abundant evidence available to substantiate the matters summarized above, much of it available in your own files. As the executive directors of a public entity, you have an obligation to follow all applicable laws. I urge you to stop payment immediately on these invalid contracts.

In addition, I also recommend that MSEC immediately demand repayment of the \$4 million transferred to MEC in June 2006 and the four \$250,000 annual installment payments paid each successive June. There is no justification for these payments, which effectively transferred \$5 million of public funds to a private non-profit in violation of state law.

MSEC should also demand reimbursement of the \$6.5 million in rent charges in excess of MEC's costs for fiscal years 2007 through 2010. MEC is fully able to repay these funds. As of Sept. 30, 2010, MEC had more than \$8 million in cash at Enterprise Bank and Fidelity Investments, another \$2.5 million in liquid assets in an Enterprise Bank investment account, and substantial equity in its various real estate holdings.

Sincerely,



Gregory W. Sullivan
Inspector General

cc: Billerica School Committee
Chelmsford School Committee
Dracut School Committee
Groton-Dunstable Regional School Committee
Nashoba Valley Technical High School Committee
North Middlesex Regional School Committee
Tewksbury School Committee
Tyngsboro School Committee
Westford School Committee
Whittier Regional Vocational Technical High School Committee